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Tuesday, April 28, 2009

Separation of powers and credible commitment

Douglass North and Niall Ferguson, among other historians, have observed the dramatic lowering of English government bond rates after the Glorious Revolution in 1688 (alternatively seen as a Dutch invasion aided and abetted by Parliamentary and City of London traitors to the House of Stuart, and a subsequent "political merger" of the former enemy nations, as Ferguson puts it). North and Ferguson have imputed these lower rates to the superiority of modern democracy which they see as having been given birth by that Revolution.

Aside from the very uncommon but verbose Jacobite, and aside from that sad majority of historians who are shallow parrots of yesterday's tabloid headlines and fail to see the importance of anything so abstract as government bond rates, there is general agreement by the remaining historians about the effect of the Revolution on the great lowering of England's bond rates. But, while the identification of the Glorious Revolution as a great improvement in the financial condition of the English government (and subsequent world dominance of the British Empire, spread of free trade, abolition of slavery, etc. -- as well as to modern evils such as historically unprecedented rates of deficit spending, taxation, and inflation) is accurate, the attribution by North and Ferguson of these lower rates to the supposed "democratic" nature of the Revolution is quite wrong.

A more accurate if rather vague view of the situation is given by Nicholas Gruen:

> Be that as it may, one of the huge things that powered us into the modern world was the idea of subjecting monarchs to the rule of law - particularly in Holland and the UK (after the Glorious Revolution of 1688). Because debtors for the first time had an expectation of being repaid when the monarch borrowed money off them, bond rates went right down and the government could borrow money. 'A free nation deep in debt' I think was the contemporary expression as Britain and Holland's stars rose.

We can be far more specific about how the Dutch Invasion of 1688 caused England's bond rates to decrease. There are rather three specific events, quite related to the rule of law but not at all related to voting of the masses (which was not a feature of England for more than a century following that Revolution), but far more pertinent to the English government's immediately subsequent ability to finance itself at low rates. The first was the Bank of England. Whatever the advantages or faults of central banking to the general economy, the Bank of England was the financial engine behind the Royal Navy's subsequent boast, factual until the 20th century, that "Britania Rules the Waves", and specifically its ability to enforce free trade and destroy slavery. The two other events are quite related. The second event was a now-obscure lawsuit against King William and Queen Mary resulting in a crucial legal opinion written

About Me

Nick Szabo

"A premier thinker about history, law and economics, and the lessons they have for security." -- Adam Shostack, Emergent Chaos

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by one of England's greatest Chief Justices, Lord Holt, in 1701. The third was a now-obscure provision of the 1701 Act of Settlement which reasserted the independence of Holt and the other English justices from both Crown and Parliament. The Bank of England is well known, but these latter two events are at least as important and deserve to be yanked from their obscurity and put into every History 101 lesson.

Justice Iredell gives a good description of *The Banker's Case* in the later U.S. case Chisholm v. Georgia. Briefly, in the case brought by banker creditors of the Crown in 1701 to collect in what was owed them under debts contracted by the Stuart kings, the House of Lords (the ultimate court of appeal), led by Lord Chief Justice Holt, held that that the Court of the Exchequer had the power to decide and remedy a case of debt brought against the Crown, and that their decision holding the debts valid and remedying them with payment from the Exchequer was proper. In this particular case, William had no power to renege, not only on debts incurred under his reign, but on the debts incurred by his Stuart predecessors Charles II and James II.

This would not have meant too much of the Crown had retained a unilateral ability to fire the justices of the Court of the Exchequer for deciding against the Crown. In the Act of Settlement Parliament determined that the Crown's justices held their posts for life "on good behavior": it would take a vote of the House of Commons, the House of Lords, *and* the concurrence of the Crown itself to impeach a justice.

The combination of *The Banker's Case* and judicial tenure for life created what economists call a credible commitment for the government to abide by its contracts. This is a comitment that neither a single person as sovereign operating under Ulpian's principle of Roman law that "the prince's will is law", nor a democratic legisulature acting under Rosseau's principle that "the general will" supposedly reflected in the enactments of this legislature are unreviewable law, can make. Such a sovereign can simply declare it to be the law that they need not abide by their contracts or by the property rights of their subjects. It is the separation of powers -- and especially an judiciary with power of final decision over contracts involving the government treasury that is as independent as possible of those tax collectors, borrowers, and repayers -- not democratic voting that makes the credible commitment of a government to repay its debts and otherwise honor its contracts possible.

Posted by Nick Szabo at 4:45 PM

2 comments:

karl said...

England was remarkably successful in leading the Grand Alliance in the War of the Spanish Succession, 1701-1714, at least until the Tories took over.

3:38 PM

Salem said...

This is an interesting viewpoint. I'm not sure if it's accurate though.

The contrary view is not that the Revolution made the country more democratic in the modern sense of mass voting, but that it made it more democratic in the 17th century sense of more Parliamentary. The reason that Stuart kings had to pay such high bond rates is not that they opportunistically defaulted on their debts - they were well aware that default would hurt them. Rather, they defaulted because of insufficient revenues - kings could not raise taxes without Parliamentary consent.

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By placing sovereignty with Crown-in-Parliament, as opposed to the Crown, the Glorious Revolution married the tax-raising power to the executive power, and hence made the executive power much more solvent, and thus able to get better bond rates. At least, this is what I was taught in school, and I don't see anything in your post to change it. After all, the government could still abrogate its debts after 1689, just it would require a Parliamentary bill, rather than an Order-in-Council. The procedure for default changed, but the possibility did not.

6:20 PM

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